Supreme Court, U.S.
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No. 94-423

In The

Supreme Court of the United States

October Term, 1994

ROSEMARY S. KOVACS; LOIS E. KOVACS; KATHLEEN L. KOVACS,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

REPLY OF PETITIONERS TO RESPONDENT'S BRIEF IN OPPOSITION

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ARGUMENT

1. Colorado Law and Michigan Law do not Differ in any Material Respect

Respondent argues that Colorado law (under which ***Brabson v. United States,*** 93-K-2228 (D.Colo.1994) was decided) and Michigan law differ. In fact, the statutory systems of the two states are very similar. Each provides for statutory interest from the date of complaint until the date the judgement is paid. (See C.R.S. § 13-21-101 and MCLA 600.6013 included in Appendix.) As the Court in ***Brabson*** correctly observed, Federal tax law cannot be determined by what states have called the property rights they have created. States create property rights but once created the tax consequences of such property rights are governed by Federal tax law. Indeed, the comments of the appellate courts of the two states are not all that different. For instance, the Michigan Supreme Court stated in ***Gordon Sel-Way, Inc. v. Spence Brothers, Inc.,*** 438 Mich. 488, 499 (1991) that "Michigan has long recognized the common-law doctrine of awarding interest as an element of damages." See Petition for Certiorari at 11-12 for the entire quote. "Under Colorado law, 'prejudgment interest is an element of compensatory damages in action for personal injuries, awarded to compensate the plaintiff for the time value of the award eventually obtained against the tortfeasor'." See Colorado cases cited in ***Brabson,*** Pet. App. 76. Further, Michigan courts repeatedly have declared that "Section 6013 is a remedial statute which is to be liberally construed in favor of a plaintiff, the intended beneficiary of the legislation." ***Rittenhouse v. Erhart,*** 424 Mich. 166, 191 (1985), ***Denham v. Bedford,*** 407 Mich. 517, 528, 287 N.W.2d 168 (1980).

"The purpose of (§ 6013) is to compensate the prevailing party for the expenses incurred in bringing an action and for the delay in receiving money damages." ***Rittenhouse,*** also at 191. The Colorado courts have declared that statutory interest is intended to compensate the Plaintiff for the time value of money but have also declared it an "element of compensatory damages." Likewise, Michigan courts have pointed out that statutory interest is intended to recompense the Plaintiff for more than just the time value of money and have declared that a remedial statute is to be interpreted to aid the Plaintiff in his quest for full compensation.

The Federal tax implications of rights created by the state statutes are a matter of Federal law. The differing terminology that different state courts have used in describing what are virtually identical property rights should not render "statutory interest" in Colorado a portion of damages excluded under Section 104(a)(2) of the Internal Revenue Code and statutory interest in Michigan "interest" and taxable. That the dicta of state courts will be mined for just such arguments is an excellent reason why this Court should review the matter and render tax law clear and uniform.

2. Respondent did Not Address the Issue of the Amendment of Section 104(a)(2)'s Provision that Lump-Sum Payments and Periodic Payments Should be Treated the Same

Respondent's brief completely ignores the fact that the 1982 amendment to Code Section 104(a)(2) provides that the amount of any damages received on account of

personal injuries or sickness are excluded from income "whether as lump-sum or periodic payments." The provision is quoted in several instances and the argument proceeds as if the phrase "lump-sum" wasn't present. In effect, Respondent has argued that a word that Congress very specifically put in the statute has no meaning and should be ignored. Only by ignoring the phrase can an argument such as that made by the Respondent on page 8 be even remotely logical. Respondent quotes the statute and proceeds to claim it refers to periodic payments only even though the portion of the statute including the term "lump-sum" is italicized right above. In fact, there is no logical argument that can be made that Congress intended items to be treated differently. It has specifically provided they will be treated the same. By act of Congress, lump-sum payments and periodic payments are to be treated the same, yet the Tax Court and Sixth Circuit have decided that such payments should be treated differently.

3. The State of the Law with Regard to the Taxability of Damages is in Great Confusion and this Court Should Clarify the Issue.

Respondent labors at great length to prove that there is no direct conflict between decisions that this Court is obligated to resolve; however, the fact is that the judicial interpretation of the term *damages* within the meaning of Code Section 104(a)(2) is in great flux and should be resolved. In ***United States v. Burke,*** 112 S. Ct. 1867 (1992), this Court held that the primary inquiry in determining whether damages are taxable is the underlying nature of the claim. If the underlying nature of the claim is a tort,

damages are excludable. If the underlying nature of the claim is a contract, the damages are includable. However, ***Burke*** dealt with damages for lost wages on a sex discrimination claim under the Federal statute, a claim which under the law as it existed at the time (though it has since been amended) did not provide for traditional tort-type remedies. Courts have now dealt with interest as "damages," (this case and ***Brabson v. United States,*** supra.) punitive damages awarded not to compensate for the personal injury but to punish as excluded (***Horton v. Commissioner,*** 100 T.C. 93, No. 8 (1993), aff'd No. 93-1928 (6th Cir. 1994)) and the taxability of Age Discrimination damages (***Commissioner v. Schleier,*** 5th Circuit unreported decision of an unreported Tax Court decision). Contrary to its argument in the instant case, Respondent in seeking review of ***Schleier*** argues that the Appellate Courts rely on different understanding of the interpretation of Code Section 104(a)(2) set forth in ***Burke.*** Respondent seeks review of ***Schleier*** not only because of conflict among the circuits (***Downey v. Commissioner,*** ___ F3d ___, 94-2 USTC ¶ 50,441, No. 93-3763 (7th Cir. 1994)) but because the issue affects thousands of individuals who have or will receive damage awards. The same is true in the instant case. The Court should grant Certiorari in this case and ***Schleier*** and settle the issue once and for all rather than sanctioning the continuing uncertainty and conflict between the Courts to be resolved piecemeal as different aspects of the problem wind their way to this Court. In short, the basic issue of ***Schleier, Horton*** and the instant case is the meaning of "damages" within the context of Section 104(a)(2) of the Internal Revenue Code.

CONCLUSION

This Court should grant Certiorari and reverse the decision of the Tax Court and Sixth Circuit.

Respectfully submitted,

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§ 13-21-101. Interest on damages

(a) In all actions brought to recover damages for personal injuries sustained by any person resulting from or occasioned by the tort of any other person, corporation, association, or partnership, whether by negligence or by willful intent of such other person, corporation, association, or partnership and whether such injury has resulted fatally or otherwise, it is lawful for the plaintiff in the complaint to claim interest on the damages alleged from the date said suit is filed; and, on and after July 1, 1979, it is lawful for the plaintiff in the complaint to claim interest on the damages claimed from the date the action accrued. When such interest is so claimed, it is the duty of the court in entering judgment for the plaintiff in such action to add to the amount of damages assessed by the verdict of the jury, or found by the court, interest on such amount calculated at the rate of nine percent per annum on actions filed on or after July 1, 1975, and at the legal rate on actions filed prior to such date, and calculated from the date such suit was filed to the date of satisfying the judgment and to include the same in said judgment as a part thereof. On actions filed on or after July 1, 1979, the calculation shall include compounding of interest annually from the date such suit was filed. On and after January 1, 1983, if a judgment for money in an action brought to recover damages for personal injuries is appealed by the judgment debtor, interest, whether prejudgment or postjudgment, shall be calculated on such sum at the rate set forth in subsections (3) and (4) of this section from the date the action accrued and shall include compounding of interest annually from the date such suit was filed.

(2)(A) If a judgment for money in an action brought to recover damages for personal injuries is appealed by a judgment debtor and the judgment is affirmed, interest, as set out in subsections (3) and (4) of this section, shall be payable from the date the action accrued until satisfaction of the judgment.

(b) If a judgment for money in an action to recover damages for personal injuries is appealed by a judgment debtor and the judgment is modified or reversed with a direction that a judgment for money be entered in the trial court, interest, as set out in subsections (3) and (4) of this section, shall be payable from the date the action accrued until the judgment is satisfied. This interest shall be payable on the amount of the final judgment.

(3) The rate of interest shall be certified on each January 1 by the secretary of state to be two percentage points above the discount rate, which discount rate shall be the rate of interest a commercial bank pays to the federal reserve bank of Kansas City using a government bond or other eligible paper as security, and shall be rounded to the nearest full percent. Such annual rate of interest shall be so established as of December 31, 1982, to become effective January 1, 1983. Thereafter, as of December 31 of each year, the annual rate of interest shall be established in the same manner, to become effective on January 1 of the following year.

(4) The rate at which interest shall accrue during each year shall be the rate which the secretary of state has certified as the annual interest rate under subsection (3) of this section.

Sec. 6013. (1) Interest shall be allowed on a money judgment recovered in a civil action, as provided in this section. However, for complaints filed on or after October 1, 1986, interest shall not be allowed on future damages from the date of filing the complaint to the date of entry of the judgment. As used in this subsection, "future damages" means that term as defined in section 6301.[1]

(2) For complaints filed before June 1, 1980, in an action involving other than a written instrument having a rate of interest exceeding 6% per year, the interest on the judgment shall be calculated from the date of filing the complaint to June 1, 1980, at the rate of 6% per year and on and after June 1, 1980, to the date of satisfaction of the judgment at the rate of 12% per year compounded annually.

(3) For complaints filed before June 1, 1980, in an action involving a written instrument having a rate of interest exceeding 6% per year, the interest on the judgment shall be calculated from the date of filing the complaint to the date of satisfaction of the judgment at the rate specified in the instrument if the rate was legal at the time the instrument was executed. However, the rate after the date judgment is entered shall not exceed the following:

(a) Seven percent per year compounded annually for any period of time between the date judgment is entered and the date of satisfaction of the judgment that elapses before June 1, 1980.

(b) Thirteen percent per year compounded annually for any period of time between the date judgment is

entered and the date of satisfaction of the judgment that elapses after May 31, 1980.

(4) For complaints filed on or after June 1, 1980, but before January 1, 1987, interest shall be calculated from the date of filing the complaint to the date of satisfaction of the judgment at the rate of 12% per year compounded annually unless the judgment is rendered on a written instrument having a higher rate of interest. In that case interest shall be calculated at the rate specified in the instrument if the rate was legal at the time the instrument was executed. The rate shall not exceed 13% per year compounded annually after the date judgment is entered.

(5) For complaints filed on or after January 1, 1987, if a judgment is rendered on a written instrument, interest shall be calculated from the date of filing the complaint to the date of satisfaction of the judgment at the rate of 12% per year compounded annually, unless the instrument has a higher rate of interest. In that case interest shall be calculated at the rate specified in the instrument if the rate was legal at the time the instrument was executed. The rate shall not exceed 13% per year compounded annually after the date judgment is entered.

(6) Except as otherwise provided in subsection (5) and subject to subsection (11), for complaints filed on or after January 1, 1987, interest on a money judgment recovered in a civil action shall be calculated at 6-month intervals from the date of filing the complaint at a rate of interest that is equal to 1% plus the average interest rate paid at auctions of 5-year United States treasury notes during the 6 months immediately preceding July 1 and

January 1, as certified by the state treasurer, and compounded annually, pursuant to this section. Interest under this subsection shall be calculated on the entire amount of the money judgment, including attorney fees and other costs. However, the amount of interest attributable to that part of the money judgment from which attorney fees are paid shall be retained by the plaintiff, and not paid to the plaintiff's attorney.

(7) If a bona fide, reasonable written offer of settlement in a civil action based on tort is made by the party against whom the judgment is subsequently rendered and is rejected by the plaintiff, the court shall order that interest not be allowed beyond the date the bona fide, reasonable written offer of settlement is filed with the court.

(8) Except as otherwise provided in subsection (1) and subject to subsections (9) and (10), if a bona fide, reasonable written offer of settlement in a civil action based on tort is not made by the party against whom the judgment is subsequently rendered, or is made and is not filed with the court, the court shall order that interest be calculated from the date of filing the complaint to the date of satisfaction of the judgment.

(9) If a civil action is based on medical malpractice and the defendant in the medical malpractice action failed to allow access to medical records as required under section 2912b(6), [2] the court shall order that interest be calculated from the date notice was given in complaint with section 2912b [3] to the date of satisfaction of the judgment.

(1) If a civil action is based on medical malpractice and the plaintiff in the medical malpractice action failed to allow access to medical records as required under section 2912b(6), the court shall order that interest be calculated from 182 days after the date the complaint was filed to the date of satisfaction of the judgment.

(11) Except as otherwise provided in subsection (1), if a bona fide, reasonable written offer of settlement in a civil action based on tort is made by a plaintiff for whom the judgment is subsequently rendered and that offer is rejected and the offer is filed with the court, the court shall order that interest be calculated from the date of the rejection of the offer to the date of satisfaction of the judgment at a rate of interest equal to 2% plus the rate of interest computed under subsection (6).

(12) A bona fide, reasonable written offer of settlement made pursuant to this section that is not accepted within 21 days after the offer is made is rejected. A rejection under this subsection or otherwise does not preclude a later offer by either party.

(13) As used in this section:

(a) "Bona fide, reasonable written offer of settlement" means:

(i) With respect to an offer of settlement made by a defendant against whom judgment is subsequently rendered, a written offer of settlement that is not less than 90% of the amount actually received by the plaintiff in the action through judgment.

(ii) With respect to an offer of settlement made by a plaintiff, a written offer of settlement that is not more

than 110% of the amount actually received by the plaintiff in the action through judgment.

(b) "Defendant" means a defendant, a counter-defendant, or a cross-defendant.

(c) "Party" means a plaintiff or a defendant.

(d) "Plaintiff" means a plaintiff, a counter-plaintiff, or a cross-plaintiff.

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[1] Section 600.6301

[2] Section 600.2912b(6)

[3] Section 600.2912b